

Honorable Judge Timothy W. Dore
Chapter 11
Hearing Location: Seattle- Courtroom 8106
Date: **January 13, 2012**
Hearing Time: 11:00 a.m.
Response Due: **January 6, 2012**

**UNITED STATES BANKRUPTCY COURT
FOR WESTERN DISTRICT OF WASHINGTON
AT SEATTLE**

In re:

SCOTT BANCHERO,

Debtor.

MICHAEL YERKOVICH,

Plaintiff

v.

SCOTT BANCHERO,

Defendant.

Chapter 11

Case No.: 11-12340

Adversary Proceeding No. 11-01542 - TWD

**DEFENDANT SCOTT BANCHERO'S
MOTION FOR SUMMARY JUDGMENT
(FRCP 56, BR 7056-1)**

In accordance with FRCP 56 and BR 7056-1, the debtor/defendant, Scott Banchero ("Banchero") respectfully submits this motion for summary judgment to dismiss this adversary proceeding with prejudice upon the grounds that no genuine issue exists with respect to any material fact and thus Banchero is entitled to dismissal of this action with prejudice.

I. STATEMENT OF UNCONTROVERTED FACTS

In accordance with BR 7056-1(b)(1), movant's statement of uncontroverted facts is submitted with this motion.

BANCHERO'S MOTION FOR SUMMARY
JUDGMENT
CASE NO. 11-01542 - TWD -

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II. INTRODUCTION AND PROCEDURAL HISTORY

On August 13, 2009, Michael Yerkovich ("Yerkovich"), acting both in a derivative and an individual capacity, commenced an action in King County Superior Court, Washington, Case No. 09-2-29940-4 (the "state court action"). The complaint alleges eight causes of action against Banchemo, individually and Pinnacle Processing Group, Inc. ("PPG"), derivatively. An authentic copy of the verified complaint is attached to the declaration of Zubel filed in support of this motion. The first cause of action alleges a breach of contract stating:

"4.4 Mr. Yerkovich and Mr. Banchemo, individually and on behalf of PPG, agreed by way of the Amendment to Contract that each of them would receive 50% of PPG's net profits.

4.5 Mr. Banchemo, individually and on behalf of PPG, breached the oral agreement between himself and Mr. Yerkovich that each of them receive an equal salary by, without limitation, paying himself an excessive salary for the years 2007 and 2008, and by characterizing compensation due and owing to Mr. Yerkovich as advances in 2007; and then claiming advances as income to Mr. Yerkovich during 2008. As a result, Mr. Yerkovich's tax liability exceeded his income for 2008.

4.6 Mr. Banchemo, individually and on behalf of PPG, breached the Amendment to Contract by, without limitation, paying himself an excessive salary for the years 2007 and 2008.

See Ex. A, p. 7, Dec. Zubel.

In addition, in the eighth cause of action, Yerkovich sought declaratory relief asking that the court declare his rights "*. . . under the amendment to contract to determine, without limitation, the amount of PPG's net profits due and owed to him.*" [See Ex. A, p. 12, ¶11.3, Dec. Zubel.]

This adversary case was filed on June 10, 2011. In his capacity as an unsecured creditor, Yerkovich is objecting to the discharge of \$406,883.16 which he alleges he has suffered for financial harm caused by Banchemo on account of Banchemo's defalcation while acting in a fiduciary capacity. This claim consists of (1) the sum of \$254,746.89 representing the judgment entered in favor of Yerkovich against Banchemo in the state court action, and (2) net profit distributions in the sum of

1 \$68,564.50 and \$86,512.17 which Yerkovich claims are owed to him from his share of the profits of
2 PPG for the calendar years 2009 and 2010 respectively. The complaint in this case alleges and
3 repeats *verbatim* the findings of fact and conclusions of law signed by the Honorable Bruce Hilyer in
4 the state court action. The complaint also alleges that Banchero should be denied a discharge with
5 respect to these claims according to 11 U.S.C. § 523(a)(4).
6

7 For the reasons set forth below, the state court judgment is dischargeable under applicable
8 bankruptcy law. With respect to the 2009 and 2010 net profit distributions to which Yerkovich claims
9 he is entitled, these claims are barred by the doctrine of *res judicata*.

10 **A. Findings of Fact**

11 The case was tried to the court between February 2 through February 8, 2011. On February
12 11, the court entered findings of fact and conclusions of law. [Ex. B, Declaration of Zubel.] The
13 court found that as a result of a 2006 amendment to a 2003 shareholder agreement between the
14 parties, Banchero "lacked the authority to set the salaries for himself and Yerkovich as that authority
15 was referred to by the PPG By-Laws, Article IV to the Board of Directors, and despite his attempts to
16 appoint himself, Banchero was never on the Board of Directors." [Ex. B, p. 10, ¶14, Dec. Zubel.]
17

18 The court also found that:

19
20 *"17. The 2006 Contract eliminated the salary for both Banchero and*
21 *Yerkovich, and deleted the above Sections 8.2 and 8.3 in their entirety, and replaced them*
with the following new sections 8.2 and 8.3:

22 *New 8.2 Distributions of Net Profits shall be made in the most advantageous*
23 *manner under the advisement of the Tax Preparer retained by "PPG"*

24 *New 8.3 The Division of Net Profits shall be an equal division, with both*
25 *"SB" and "MY" receiving a 50% share*

26 *18. In 2007, 2008 and previously, "Banchero distributed PPG's cash transferred*
funds directly to himself and Yerkovich and in some cases to directly to his creditors based
upon cash flow. As is the practice in many closely held firms, these amounts were initially

1 classified as "loans" on PPG's corporate records. There were no loan documents for these
2 loans, and there was no interest paid on these loans. At the end of the year, Banchemo
3 alone would decide how much of the loans would be classified as salary, or loans, or remain
4 as profit distributions for both himself and Yerkovich. PPG was converted into an S
5 Corporation on the same day the 2006 Contract was signed which eliminated the risk of
double taxation since the income of the corporation is passed through to the
shareholders." [Ex.B, p. 11, ¶17 and 18, Dec. Zubel.]

6 The court then performed an analysis of salary distributions which Banchemo and Yerkovich
7 received for the calendar years 2007 and 2008. The court found:

8 "19. Banchemo set his own salary at \$300,000 for 2007 and \$450,000 for 2008
9 while setting Yerkovich's at \$100,000 for 2007 and \$275,000 for 2008. Further, since
10 Yerkovich's 2007 salary was set so low relative to the cash that had been disbursed to
11 him the effect was to push his tax liability forward into 2008. While Yerkovich did sign
12 his personal IRS Form for 2007 which showed his \$100,000 salary that did not put
13 him on notice that Banchemo had paid himself \$300,000. Nor did he know that the
14 next year, all of the 2007 loans would be included in his 2008 income such that he got
15 about \$128,000 in distributions but would have to pay tax on about \$275,000. But in
16 2008, Banchemo did not extend the PPG "loans" to Yerkovich any longer, and
17 Yerkovich having no notice or knowledge of Banchemo's decisions, failed to request
18 adequate withholding to prepare for his tax liability from income attributable to 2007
19 and 2008. However, while Banchemo had in theory the same tax problem, he used his
control over PPG's funds to insure that he had no tax problems and instead had PPG
pay about \$104,000 of his tax liability directly to the IRS. Worse still, he did not even
carry this "loan" on PPG's books; it just doesn't appear on the "loan to Scott"
spreadsheet for 2008. Obviously aware of how this looked, on the last day of trial he
acknowledged this was an "error of judgment" and stated he intended to pay it back to
PPG. But Banchemo's unequal treatment of himself and Yerkovich was more than a
mere error of judgment, it was a series of deliberate acts of corporate self-dealing
and misuse of use of corporate resources." [Ex. B, p. 12, ¶19, Dec. Zubel.]

20 The court acknowledged that " . . . [P]laintiff presented two alternative summaries of
21 damages." [Ex. __, p. 13, ¶25, Dec. Zubel.]

22 The court then made an arithmetic calculation of the amount to which Yerkovich was entitled
23 for his "share" of PPG's "total profits." Finding 26 provides:

24 "26. Taking into account the funds received by both parties, as Plaintiffs have
25 pointed out should be considered, results in the following damages calculations: In
26 2007, Pl (sic) got distributions of \$292,633.94 and Banchemo received \$347,657.24,
for total profits of \$640,291.18. Under the 2006 Contract, Yerkovich was owed 50 %
of that amount = \$320,145.59 which means that Banchemo owes him \$27,511.65 over

1 the distributions already received, plus prejudgment interest a 12% per annum (1%
2 per month) since December 31, 2007 for 37.5 months = \$10,316.87 In 2008,
3 Yerkovich received distributions of \$128,432.40 and Banchemo received \$450,000
4 (including the \$104,000 he acknowledges he would otherwise owe PPG for his 2008
5 IRS taxes, and allowing him to carry forward his loan balance of \$53,973.01 which
6 Plaintiffs did not contest) for total PPG net profits of \$578,432.40 on which Yerkovich
7 was owed 50%= \$289,216.20 which means he is owed an additional \$160,783.8 plus
8 interest since December 31, 2008 for 25.5 months = \$40,999.87. The total of damages
9 awarded is therefore \$239,612.19. This compares relatively closely with Yerkovich's
10 expert opinion that damages were between about \$241,000 and \$246,000."
11 [Ex. B, p. 14, ¶26, Dec. Zubel.]

12 **B. Conclusions of Law**

13 The court made the following conclusions of law interpreting the 2003 and 2006 agreements
14 in light of the parties' performance. The court concluded,

15 *"A. Breach of Contract*

16 1. Banchemo and Yerkovich entered a binding contract in 2006 to split
17 PPG's profits 50/50 in. The method of such distribution was to be determined in
18 consultation with PPG's accountant to make it tax advantageous to all concerned.

19 2. The actions of Banchemo in setting his own salary at \$300,000 in 2007
20 and \$450,000 in 2008, while setting Yerkovich's at \$100,000 in 2007 and \$275,000 in
21 2008 were in breach of the 2006 Contracts.

22 3. The 2006 Contract did not permit Banchemo to unilaterally set salaries or
23 to set salaries more favorable to him than to Yerkovich. The actions of Banchemo in
24 unilaterally determining that the amounts advanced to Yerkovich to be treated as loans
25 instead of salary were in violation of the 2006 Contract.

26 4. To remedy the breach of contract by Banchemo (sic), Yerkovic (sic) is entitled
to an award of damages, including prejudgment interest of \$239,912.19." . [Ex. B,
p. 15, ¶1-4, Dec. Zubel]

The court also concluded that the 2006 contract would not allow Banchemo to unilaterally
distribute the profits of PPG by setting salaries as this would " . . . frustrate the purpose of the 2006
contract which was to treat both shareholders equally." [Ex. B, p. 15, ¶5, Dec. Zubel] From this
premise the court concluded:

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IV. ARGUMENT

A. *The plaintiff can prove no set of facts entitling him to relief under 11 U.S.C. § 523(a)(4), because Banchemo was not acting in a "fiduciary capacity" in connection with an express or technical trust.*

The definition of "fiduciary capacity" in the discharge exception for fiduciary fraud or defalcation is a question of federal law under 11 U.S.C. § 523(a)(4). The Ninth Circuit has adopted a narrow definition of "fiduciary" for purposes of the discharge exception for fiduciary fraud or defalcation. The fiduciary relationship or fiduciary capacity must be one arising from an express or technical trust that was imposed *before* and without reference to the wrongdoing that caused the debt. In defining the term "fiduciary" for purposes of the discharge exception for fiduciary fraud or defalcation, while governed by federal law, the Ninth Circuit has held that courts may rely in part on state law to ascertain whether the requisite trust relationship exists. *See, In re Gregory Dewitt Cantrell, 329 F.3d 1119 (9th Cir. 2003).* In that case, a state court judgment was entered as a final judgment against the debtor found to have been engaged in fraudulent conduct in his capacity as a corporate officer. While the debtor was collaterally estopped from re-litigating that issue in bankruptcy, he was not collaterally estopped from contesting whether the (default) judgment was dischargeable.

In applying California law, the court held that a corporate officer is not a "fiduciary" within the meaning of the discharge exception for fiduciary fraud or defalcation. Notwithstanding the fact that under California law officers owe fiduciary duties in their capacities as agents of a corporation, they are not *trustees* of a statutory trust with respect to corporate assets.

While *Cantrell* was decided by applying the definition of "fiduciary" under California law, the same result is reached under Washington law. Cited with approval in *Cantrell* is *Alexander and Alexander of Washington, Inc. v Hultquist, 101 B.R. 180 (9th Cir. BAP 1989).* In *Hultquist*, the debtor

1 sold a life insurance policy on behalf of his personal corporation and personally received a \$20,000
2 commission. In dismissing the employer's non-dischargeability claim brought pursuant to 523(a)(4)
3 on the basis of an alleged pre-existing fiduciary duty, the BAP affirmed Judge Glover by holding that
4 because no express trust existed between the employer and the debtor, application of Washington case
5 law that corporate officers owe a "fiduciary duty" to the corporation does not fall within the
6 definition of fiduciary under 523 (a)(4) in the absence of a pre-existing or statutorily created trust at
7 the time of the alleged wrongdoing.
8

9 The court stated that,

10 *"Although the debtor may have owed a general fiduciary duty as a corporate officer*
11 *under state law, no **pre-existing or statutorily created trust** existed at the time of the*
12 *alleged wrongdoing."* [Emphasis in original] 101 B.R. at 185.

13 As a matter of law, the state court judgment is dischargeable.

14 ***B. Yerkovich's claims for 2009 and 2010 net profit distributions are barred by the***
15 ***doctrine of res judicata.***

16 Yerkovich claims that he is entitled to recover net profit distributions from Banchemo as a
17 result of salaries which Banchemo received from PPG for the calendar years 2009 and 2010.
18 Yerkovich could have asserted these claims in the state court action, but failed to do so, having
19 unsuccessfully attempted to include these claims during trial in the state court. See, declaration of
20 Zubel, page 2, ¶ 5.

21 In *Soundbuilt Northwest, LLC, v. Price*, 2011 WL 4929137 (Wash. App. Div. 2, October 18,
22 2011), the Court of Appeals defined *res judicata* as claim preclusion barring the re-litigation of claims
23 and issues that were litigated, or *could have been litigated*, in a prior action. Citing *Pederson v.*
24 *Potter*, 103 Wn.App. 62, 69, 11 P.3d 833 (2000). Filing two separate lawsuits based on the same
25 events, or claim splitting, is precluded in Washington. See *Ensley v. Pitcher*, 152 Wn.App. 891, 898-
26 99, 222 P.3d 99 (2009). The court went on to observe that:

1 calendar years 2009 and 2010 are barred by the doctrine of *res judicata*, and order that this case be
2 dismissed with prejudiced.

3 DATED: December 15, 2011.

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5 Moving Party,

6 ERIC ZUBEL, PC

7
8 By: 

9 Eric Zubel, WSBA #33961

10 Attorney for Defendant/Counterclaimant,
11 Scott Banchemo

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CERTIFICATE OF SERVICE

The undersigned certifies that on the date recited below, I electronically filed the foregoing with the Clerk of the Court using the CM/ECF system which will send notification of such filing to the following:

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DATED this 15th day of December, 2011.

Cathy Hodges
Cathy Hodges, An Employee of Eric Zubel, PC